

CHAPTER 14

CORPORATIONS: DIVIDENDS, RETAINED EARNINGS, AND INCOME REPORTING

SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT
True-False Statements														
1.	1	K	7.	2	K	13.	2	C	19.	4	K	25.	5	K
2.	1	K	8.	2	K	14.	3	K	20.	4	K	^{sg} 26.	1	K
3.	1	K	9.	2	K	15.	3	K	21.	5	K	^{sg} 27.	1	K
4.	1	C	10.	2	K	16.	3	K	22.	5	K	^{sg} 28.	2	K
5.	1	C	11.	2	K	17.	3	K	23.	5	K	^{sg} 29.	4	C
6.	2	K	12.	2	K	18.	4	C	24.	5	K	^{sg} 30.	5	K
Multiple Choice Questions														
31.	1	K	50.	1	C	69.	1	C	88.	2	K	107.	4	C
32.	1	K	51.	1	K	70.	1	C	89.	2	K	108.	4	C
33.	1	K	52.	1	C	71.	1	AP	90.	2	C	109.	4	K
34.	1	K	53.	1	C	72.	1	AP	91.	2	C	110.	5	K
35.	1	K	54.	1	C	73.	1	AP	92.	2	C	111.	5	K
36.	1	C	55.	1	C	74.	1	C	93.	2	K	112.	5	AP
37.	1	C	56.	1	AP	75.	1	C	94.	2	K	113.	5	K
38.	1	K	57.	1	AP	76.	1	AP	95.	2	C	^{sg} 114.	1	C
39.	1	C	58.	1	AP	77.	1	AP	96.	2	K	st 115.	1	K
40.	1	C	59.	1	AP	78.	1	AP	97.	2	C	^{sg} 116.	1	K
41.	1	C	60.	1	AP	79.	1	AP	98.	2	C	^{sg} 117.	2	C
42.	1	C	61.	1	K	80.	1	AP	99.	3	K	st 118.	2	K
43.	1	K	62.	1	K	81.	1	AP	100.	3	K	^{sg} 119.	3	AP
44.	1	K	63.	1	C	82.	1	AP	101.	3	K	st 120.	3	K
45.	1	K	64.	1	C	83.	1	AP	102.	3	AP	^{sg} 121.	5	AP
46.	1	K	65.	1	K	84.	1	AP	103.	5	AP	st 122.	5	K
47.	1	K	66.	1	K	85.	1	AP	104.	3	AP	^{sg} 123.	5	K
48.	1	K	67.	1	K	86.	2	AP	105.	5	AP			
49.	1	K	68.	1	C	87.	2	AP	106.	4	C			
Brief Exercises														
124.	1	AP	126.	1	AP	128.	1	C	130.	2	AP	132.	4	AP
125.	1	AP	127.	1	AP	129.	2	K	131.	3	AP			
Exercises														
133.	1	AP	137.	1	AP	141.	1	AP	145.	3	AP	149.	5	AP
134.	1	AP	138.	1–3	C	142.	2	AN	146.	3	AP	150.	5	AP
135.	1	AP	139.	1	AP	143.	2	AP	147.	3	AP	151.	5	AP
136.	1	AP	140.	1,3	AP	144.	2	AP	148.	4	AP			

^{sg} This question also appears in the Study Guide.

st This question also appears in a self-test at the student companion website.

Completion Statements														
152.	1	K	154.	1	K	156.	2	K	158.	3	K	160.	5	K
153.	1	K	155.	2	K	157.	3	K	159.	4	K	161.	5	K

SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Study Objective 1													
1.	TF	36.	MC	48.	MC	60.	MC	72.	MC	84.	MC	135.	Ex
2.	TF	37.	MC	49.	MC	61.	MC	73.	MC	85.	MC	136.	Ex
3.	TF	38.	MC	50.	MC	62.	MC	74.	MC	114.	MC	137.	Ex
4.	TF	39.	MC	51.	MC	63.	MC	75.	MC	115.	MC	138.	Ex
5.	TF	40.	MC	52.	MC	64.	MC	76.	MC	116.	MC	139.	Ex
26.	TF	41.	MC	53.	MC	65.	MC	77.	MC	124.	BE	140.	Ex
27.	TF	42.	MC	54.	MC	66.	MC	78.	MC	125.	BE	141.	Ex
31.	MC	43.	MC	55.	MC	67.	MC	79.	MC	126.	BE	152.	C
32.	MC	44.	MC	56.	MC	68.	MC	80.	MC	127.	BE	153.	C
33.	MC	45.	MC	57.	MC	69.	MC	81.	MC	128.	BE	154.	C
34.	MC	46.	MC	58.	MC	70.	MC	82.	MC	133.	Ex		
35.	MC	47.	MC	59.	MC	71.	MC	83.	MC	134.	Ex		
Study Objective 2													
6.	TF	11.	TF	87.	MC	92.	MC	97.	MC	130.	BE	155.	C
7.	TF	12.	TF	88.	MC	93.	MC	98.	MC	138.	Ex	156.	C
8.	TF	13.	TF	89.	MC	94.	MC	117.	MC	142.	Ex		
9.	TF	28.	TF	90.	MC	95.	MC	118.	MC	143.	Ex		
10.	TF	86.	MC	91.	MC	96.	MC	129.	BE	144.	Ex		
Study Objective 3													
14.	TF	17.	TF	101.	MC	119.	MC	138.	Ex	146.	Ex	158.	C
15.	TF	99.	MC	102.	MC	120.	MC	140.	Ex	147.	Ex		
16.	TF	100.	MC	104.	MC	131.	BE	145.	Ex	157.	C		
Study Objective 4													
18.	TF	20.	TF	106.	MC	108.	MC	132.	BE	159.	C		
19.	TF	29.	TF	107.	MC	109.	MC	148.	Ex				
Study Objective 5													
21.	TF	24.	TF	103.	MC	111.	MC	121.	MC	149.	Ex	160.	C
22.	TF	25.	TF	105.	MC	112.	MC	122.	MC	150.	Ex	161.	C
23.	TF	30.	TF	110.	MC	113.	MC	123.	MC	151.	Ex		

Note: TF = True-False
MC = Multiple Choice

BE = Brief Exercise
Ex = Exercise

C = Completion

The chapter also contains one set of ten Matching questions and five Short-Answer Essay questions.

CHAPTER STUDY OBJECTIVES

1. ***Prepare the entries for cash dividends and stock dividends.*** Companies make entries for both cash and stock dividends at the declaration date and at the payment date. At the declaration date the entries are: cash dividend—debit Retained Earnings, and credit Dividends Payable; small stock dividend—debit Retained Earnings, credit Paid-in Capital in Excess of Par (or Stated) Value, and credit Common Stock Dividends Distributable. At the payment date, the entries for cash and stock dividends are: cash dividend—debit Dividends Payable and credit Cash; small stock dividend—debit Common Stock Dividends Distributable and credit Common Stock.
2. ***Identify the items reported in a retained earnings statement.*** Companies report each of the individual debits and credits to retained earnings in the retained earnings statement. Additions consist of net income and prior period adjustments to correct understatements of prior years' net income. Deductions consist of net loss, adjustments to correct overstatements of prior years' net income, cash and stock dividends, and some disposals of treasury stock.
3. ***Prepare and analyze a comprehensive stockholders' equity section.*** A comprehensive stockholders' equity section includes all stockholders' equity accounts. It consists of two sections: paid-in capital and retained earnings. It should also include notes to the financial statements that explain any restrictions on retained earnings and any dividends in arrears. One measure of profitability is the return on common stockholders' equity. It is calculated by dividing net income minus preferred stock dividends by average common stockholders' equity.
4. ***Describe the form and content of corporation income statements.*** The form and content of corporation income statements are similar to the statements of proprietorships and partnerships with one exception: Corporations must report income taxes or income tax expense in a separate section before net income in the income statement.
5. ***Compute earnings per share.*** Companies compute earnings per share by dividing net income by the weighted-average number of common shares outstanding during the period. When preferred stock dividends exist, they must be deducted from net income in order to calculate EPS.

TRUE-FALSE STATEMENTS

1. Dividends may be declared and paid in cash or stock.
2. Cash dividends are not a liability of the corporation until they are declared by the board of directors.
3. The amount of a cash dividend liability is recorded on the date of record because it is on that date that the persons or entities who will receive the dividend are identified.
4. A 10% stock dividend will increase the number of shares outstanding but the book value per share will decrease.
5. A 3 for 1 common stock split will increase total stockholders' equity but reduce the par or stated value per share of common stock.
6. Retained earnings represents the amount of cash available for dividends.
7. Net income of a corporation should be closed to retained earnings and net losses should be closed to paid-in capital accounts.
8. A debit balance in the Retained Earnings account is identified as a deficit.
9. A correction in income of a prior period involves either a debit or credit to the Retained Earnings account.
10. Prior period adjustments to income are reported in the current year's income statement.
11. Retained earnings that are restricted are unavailable for dividends.
12. Restricted retained earnings are available for preferred stock dividends but unavailable for common stock dividends.
13. A retained earnings statement shows the same information as a corporation income statement.
14. A detailed stockholders' equity section in the balance sheet will list the names of individuals who are eligible to receive dividends on the date of record.
15. Common Stock Dividends Distributable is shown within the Paid-in Capital subdivision of the stockholders' equity section of the balance sheet.
16. Return on common stockholders' equity is computed by dividing net income by ending stockholders' equity.
17. Many companies prepare a stockholders' equity statement instead of presenting a detailed stockholders' equity section in the balance sheet.
18. A major difference among corporations, proprietorships, and partnerships is that a corporation's income statement reports income tax expense.
19. A corporation incurs income tax expense only if it pays dividends to stockholders.

20. Income tax expense usually appears as a separate section on a corporation income statement.
21. Earnings per share is calculated by dividing net income by the weighted average number of shares of preferred stock and common stock outstanding.
22. Preferred dividends paid are added back to net income in calculating earnings per share for common stockholders.
23. Earnings per share indicates the net income earned by each share of outstanding common stock.
24. Earnings per share is reported for both preferred and common stock.
25. Most companies are required to report earnings per share on the face of the income statement.

Additional True-False Questions

26. A dividend based on paid-in capital is termed a liquidating dividend.
27. Common Stock Dividends Distributable is reported as additional paid-in capital in the stockholders' equity section.
28. A prior period adjustment is reported as an adjustment of the beginning balance of Retained Earnings.
29. Income tax expense and the related liability for income taxes payable are recorded when taxes are paid.
30. Earnings per share is reported only for common stock.

Answers to True-False Statements

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	T	6.	F	11.	T	16.	F	21.	F	26.	T
2.	T	7.	F	12.	F	17.	T	22.	F	27.	F
3.	F	8.	T	13.	F	18.	T	23.	T	28.	T
4.	T	9.	T	14.	F	19.	F	24.	F	29.	F
5.	F	10.	F	15.	T	20.	T	25.	T	30.	T

MULTIPLE CHOICE QUESTIONS

31. Each of the following decreases retained earnings *except* a
 - a. cash dividend.
 - b. liquidating dividend.
 - c. stock dividend.
 - d. All of these decrease retained earnings.

32. Each of the following decreases total stockholders' equity *except* a
 - a. cash dividend.
 - b. liquidating dividend.
 - c. stock dividend.
 - d. All of these decrease total stockholders' equity.

33. Which one of the following is *not* necessary in order for a corporation to pay a cash dividend?
 - a. Adequate cash
 - b. Approval of stockholders
 - c. Declaration of dividends by the board of directors
 - d. Retained earnings

34. If a corporation declares a dividend based upon paid-in capital, it is known as a
 - a. scrip dividend.
 - b. property dividend.
 - c. paid dividend.
 - d. liquidating dividend.

35. The date on which a cash dividend becomes a binding legal obligation is on the
 - a. declaration date.
 - b. date of record.
 - c. payment date.
 - d. last day of the fiscal year-end.

36. The effect of the declaration of a cash dividend by the board of directors is to

Increase	Decrease
a. Stockholders' equity	Assets
b. Assets	Liabilities
c. Liabilities	Stockholders' equity
d. Liabilities	Assets

37. The cumulative effect of the declaration and payment of a cash dividend on a company's financial statements is to
 - a. decrease total liabilities and stockholders' equity.
 - b. increase total expenses and total liabilities.
 - c. increase total assets and stockholders' equity.
 - d. decrease total assets and stockholders' equity.

38. Common Stock Dividends Distributable is classified as a(n)
- asset account.
 - stockholders' equity account.
 - expense account.
 - liability account.
39. The effect of a stock dividend is to
- decrease total assets and stockholders' equity.
 - change the composition of stockholders' equity.
 - decrease total assets and total liabilities.
 - increase the book value per share of common stock.
40. If a corporation declares a 10% stock dividend on its common stock, the account to be debited on the date of declaration is
- Common Stock Dividends Distributable.
 - Common Stock.
 - Paid-in Capital in Excess of Par.
 - Retained Earnings.
41. Which one of the following events would *not* require a formal journal entry on a corporation's books?
- 2 for 1 stock split
 - 100% stock dividend
 - 2% stock dividend
 - \$1 per share cash dividend
42. Stock dividends and stock splits have the following effects on retained earnings:
- | | <u>Stock Splits</u> | <u>Stock Dividends</u> |
|----|---------------------|------------------------|
| a. | Increase | No change |
| b. | No change | Decrease |
| c. | Decrease | Decrease |
| d. | No change | No change |
43. Dividends are predominantly paid in
- scrip.
 - property.
 - cash.
 - stock.
44. If a stockholder receives a dividend consisting of a promissory note, the stockholder has received a
- stock dividend.
 - cash dividend.
 - contingent dividend.
 - scrip dividend.
45. Of the four dividends types, the two most common types in practice are
- cash and scrip.
 - cash and property.
 - cash and stock.
 - property and stock.

46. Regular dividends are declared out of
- Paid-in Capital in Excess of Par Value.
 - Treasury Stock.
 - Common Stock.
 - Retained Earnings.
47. A corporation is committed to a legal obligation when it declares
- a cash dividend.
 - either a cash dividend or a stock dividend.
 - a stock dividend.
 - a stock split.
48. Which of the following is *not* a significant date with respect to dividends?
- The declaration date
 - The incorporation date
 - The record date
 - The payment date
49. On the dividend record date,
- a dividend becomes a current obligation.
 - no entry is required.
 - an entry may be required if it is a stock dividend.
 - Dividends Payable is debited.
50. Which of the following statements regarding the date of a cash dividend declaration is *not* accurate?
- The dividend can be rescinded once it has been declared.
 - The corporation is committed to a legal, binding obligation.
 - The board of directors formally authorizes the cash dividend.
 - A liability account must be increased.
51. Dividends Payable is classified as a
- long-term liability.
 - contra stockholders' equity account to Retained Earnings.
 - current liability.
 - stockholders' equity account.
52. Indicate the respective effects of the declaration of a cash dividend on the following balance sheet sections:
- | | <u>Total Assets</u> | <u>Total Liabilities</u> | <u>Total Stockholders' Equity</u> |
|----|---------------------|--------------------------|-----------------------------------|
| a. | Increase | Decrease | No change |
| b. | No change | Increase | Decrease |
| c. | Decrease | Increase | Decrease |
| d. | Decrease | No change | Increase |
53. Which of the following statements about dividends is *not* accurate?
- Many companies declare and pay cash quarterly dividends.
 - Low dividends may mean high stock returns.
 - The board of directors is obligated to declare dividends.
 - A legal dividend may not be a feasible one.

54. The cumulative effect of the declaration and payment of a cash dividend on a company's balance sheet is to
- decrease current liabilities and stockholders' equity.
 - increase total assets and stockholders' equity.
 - increase current liabilities and stockholders' equity.
 - decrease stockholders' equity and total assets.
55. The declaration and distribution of a stock dividend will
- increase total stockholders' equity.
 - increase total assets.
 - decrease total assets.
 - have no effect on total assets.
56. ABC, Inc. has 1,000 shares of 4%, \$100 par value, cumulative preferred stock and 50,000 shares of \$1 par value common stock outstanding at December 31, 2008. What is the annual dividend on the preferred stock?
- \$40 per share
 - \$4,000 in total
 - \$400 in total
 - \$.40 per share
57. Agler, Inc. has 10,000 shares of 6%, \$100 par value, cumulative preferred stock and 100,000 shares of \$1 par value common stock outstanding at December 31, 2008. If the board of directors declares a \$50,000 dividend, the
- preferred shareholders will receive 1/10th of what the common shareholders will receive.
 - preferred shareholders will receive the entire \$50,000.
 - \$50,000 will be held as restricted retained earnings and paid out at some future date.
 - preferred shareholders will receive \$25,000 and the common shareholders will receive \$25,000.
58. Manner, Inc. has 5,000 shares of 6%, \$100 par value, noncumulative preferred stock and 20,000 shares of \$1 par value common stock outstanding at December 31, 2008. There were no dividends declared in 2007. The board of directors declares and pays a \$55,000 dividend in 2008. What is the amount of dividends received by the common stockholders in 2008?
- \$0
 - \$30,000
 - \$55,000
 - \$25,000
59. Lopez, Inc. has 2,000 shares of 6%, \$50 par value, cumulative preferred stock and 50,000 shares of \$1 par value common stock outstanding at December 31, 2007, and December 31, 2008. The board of directors declared and paid a \$4,000 dividend in 2007. In 2008, \$20,000 of dividends are declared and paid. What are the dividends received by the preferred and common shareholders in 2008?
- | | <u>Preferred</u> | <u>Common</u> |
|----|------------------|---------------|
| a. | \$12,000 | \$8,000 |
| b. | \$10,000 | \$10,000 |
| c. | \$8,000 | \$12,000 |
| d. | \$6,000 | \$14,000 |

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60. Norton, Inc. has 10,000 shares of 6%, \$100 par value, noncumulative preferred stock and 100,000 shares of \$1 par value common stock outstanding at December 31, 2008, and December 31, 2009. The board of directors declared and paid a \$50,000 dividend in 2008. In 2009, \$100,000 of dividends are declared and paid. What are the dividends received by the preferred and common shareholders in 2009?

	<u>Preferred</u>	<u>Common</u>
a.	\$0	\$100,000
b.	\$60,000	\$40,000
c.	\$50,000	\$50,000
d.	\$100,000	\$0

61. The board of directors must assign a per share value to a stock dividend declared that is
- greater than the par or stated value.
 - less than the par or stated value.
 - equal to the par or stated value.
 - at least equal to the par or stated value.
62. Corporations generally issue stock dividends in order to
- increase the market price per share.
 - exceed stockholders' dividend expectations.
 - increase the marketability of the stock.
 - decrease the amount of capital in the corporation.
63. A stockholder who receives a stock dividend would
- expect the market price per share to increase.
 - own more shares of stock.
 - expect retained earnings to increase.
 - expect the par value of the stock to change.
64. When stock dividends are distributed,
- Common Stock Dividends Distributable is decreased.
 - Retained Earnings is decreased.
 - Paid-in Capital in Excess of Par Value is debited if it is a small stock dividend.
 - no entry is necessary if it is a large stock dividend.
65. A small stock dividend is defined as
- less than 30% but greater than 25% of the corporation's issued stock.
 - between 50% and 100% of the corporation's issued stock.
 - more than 30% of the corporation's issued stock.
 - less than 20–25% of the corporation's issued stock.
66. The per share amount normally assigned by the board of directors to a large stock dividend is
- the market value of the stock on the date of declaration.
 - the average price paid by stockholders on outstanding shares.
 - the par or stated value of the stock.
 - zero.

67. The per share amount normally assigned by the board of directors to a small stock dividend is
- the market value of the stock on the date of declaration.
 - the average price paid by stockholders on outstanding shares.
 - the par or stated value of the stock.
 - zero.
68. Identify the effect the declaration of a stock dividend has on the par value per share and book value per share.
- | | <u>Par Value per Share</u> | <u>Book Value per Share</u> |
|----|----------------------------|-----------------------------|
| a. | Increase | Decrease |
| b. | No effect | Increase |
| c. | Decrease | Decrease |
| d. | No effect | Decrease |
69. The declaration of a stock dividend will
- increase paid-in capital.
 - change the total of stockholders' equity.
 - increase total liabilities.
 - increase total assets.
70. Which of the following show the proper effect of a stock split and a stock dividend?
- | | <u>Item</u> | <u>Stock Split</u> | <u>Stock Dividend</u> |
|----|--------------------------|--------------------|-----------------------|
| a. | Total paid-in capital | Increase | Increase |
| b. | Total retained earnings | Decrease | Decrease |
| c. | Total par value (common) | Decrease | Increase |
| d. | Par value per share | Decrease | No change |
71. A stock split
- may occur in the absence of retained earnings.
 - will increase total paid-in capital.
 - will increase the total par value of the stock.
 - will have no effect on the par value per share of stock.
72. Outstanding stock of the Apex Corporation included 20,000 shares of \$5 par common stock and 5,000 shares of 6%, \$10 par noncumulative preferred stock. In 2007, Apex declared and paid dividends of \$2,000. In 2008, Apex declared and paid dividends of \$6,000. How much of the 2008 dividend was distributed to preferred shareholders?
- \$4,000
 - \$7,000
 - \$3,000
 - None of the above
73. Outstanding stock of the Bell Corporation included 20,000 shares of \$5 par common stock and 10,000 shares of 6%, \$10 par noncumulative preferred stock. In 2007, Bell declared and paid dividends of \$4,000. In 2008, Bell declared and paid dividends of \$12,000. How much of the 2008 dividend was distributed to preferred shareholders?
- \$8,000
 - \$14,000
 - \$6,000
 - None of the above

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74. On January 1, Bluefield Corporation had 800,000 shares of \$10 par value common stock outstanding. On March 31, the company declared a 10% stock dividend. Market value of the stock was \$15/share. As a result of this event,
- a. Bluefield's Paid-in Capital in Excess of Par Value account increased \$400,000.
 - b. Bluefield's total stockholders' equity was unaffected.
 - c. Bluefield's Retained Earnings account decreased \$1,200,000.
 - d. All of the above.
75. On January 1, Garrison Corporation had 1,000,000 shares of \$10 par value common stock outstanding. On March 31, the company declared a 10% stock dividend. Market value of the stock was \$15/share. As a result of this event,
- a. Garrison's Paid-in Capital in Excess of Par Value account increased \$500,000.
 - b. Garrison's total stockholders' equity was unaffected.
 - c. Garrison's Retained Earnings account decreased \$1,500,000.
 - d. All of the above.
76. Sun Inc. has 5,000 shares of 6%, \$100 par value, cumulative preferred stock and 50,000 shares of \$1 par value common stock outstanding at December 31, 2008. What is the annual dividend on the preferred stock?
- a. \$60 per share
 - b. \$30,000 in total
 - c. \$3,000 in total
 - d. \$0.60 per share
77. Allstate, Inc., has 20,000 shares of 6%, \$100 par value, noncumulative preferred stock and 100,000 shares of \$1 par value common stock outstanding at December 31, 2008. If the board of directors declares a \$200,000 dividend, the
- a. preferred stockholders will receive $\frac{2}{10}$ of what the common stockholders will receive.
 - b. preferred stockholders will receive the entire \$200,000.
 - c. \$120,000 will be held as restricted retained earnings and paid out at some future date.
 - d. preferred stockholders will receive \$120,000 and the common stockholders will receive \$80,000.
78. Archer, Inc., has 10,000 shares of 8%, \$100 par value, noncumulative preferred stock and 40,000 shares of \$1 par value common stock outstanding at December 31, 2008. There were no dividends declared in 2007. The board of directors declares and pays a \$120,000 dividend in 2008. What is the amount of dividends received by the common stockholders in 2008?
- a. \$0
 - b. \$80,000
 - c. \$120,000
 - d. \$40,000
79. Luther Inc., has 2,000 shares of 8%, \$50 par value, cumulative preferred stock and 100,000 shares of \$1 par value common stock outstanding at December 31, 2008, and December 31, 2007. The board of directors declared and paid a \$6,000 dividend in 2007. In 2008, \$24,000 of dividends are declared and paid. What are the dividends received by the preferred stockholders in 2008?

- a. \$14,000
 - b. \$12,000
 - c. \$10,000
 - d. \$8,000
80. Anders, Inc., has 5,000 shares of 6%, \$100 par value, cumulative preferred stock and 20,000 shares of \$1 par value common stock outstanding at December 31, 2009. There were no dividends declared in 2007. The board of directors declares and pays a \$50,000 dividend in 2008 and in 2009. What is the amount of dividends received by the common stockholders in 2009?
- a. \$10,000
 - b. \$30,000
 - c. \$50,000
 - d. \$0
81. Cuther Inc., has 1,000 shares of 8%, \$50 par value, cumulative preferred stock and 50,000 shares of \$1 par value common stock outstanding at December 31, 2007, and December 31, 2008. The board of directors declared and paid a \$3,000 dividend in 2007. In 2008, \$12,000 of dividends are declared and paid. What are the dividends received by the common stockholders in 2008?
- a. \$7,000
 - b. \$6,000
 - c. \$5,000
 - d. \$4,000
82. On January 1, Brunner Corporation had 60,000 shares of \$10 par value common stock outstanding. On March 17, the company declared a 10% stock dividend to stockholders of record on March 20. Market value of the stock was \$13 on March 17. The entry to record the transaction of March 17 would include a
- a. credit to Retained Earnings for \$18,000.
 - b. credit to Cash for \$78,000.
 - c. credit to Common Stock Dividends Distributable for \$60,000.
 - d. debit to Common Stock Dividends Distributable for \$60,000.
83. On January 1, Brunner Corporation had 60,000 shares of \$10 par value common stock outstanding. On March 17, the company declared a 10% stock dividend to stockholders of record on March 20. Market value of the stock was \$13 on March 17. The stock was distributed on March 30. The entry to record the transaction of March 30 would include a
- a. credit to Cash for \$60,000.
 - b. debit to Common Stock Dividends Distributable for \$60,000.
 - c. credit to Paid-in Capital in Excess of Par Value for \$18,000.
 - d. debit to Retained Earnings for \$18,000.
84. On January 1, Sandford Corporation had 80,000 shares of \$10 par value common stock outstanding. On June 17, the company declared a 10% stock dividend to stockholders of record on June 20. Market value of the stock was \$15 on June 17. The entry to record the transaction of June 17 would include a
- a. debit to Retained Earnings for \$120,000.
 - b. credit to Cash for \$120,000.
 - c. credit to Common Stock Dividends Distributable for \$120,000.
 - d. credit to Common Stock Dividends Distributable for \$40,000.

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85. On January 1, Sanford Corporation had 80,000 shares of \$10 par value common stock outstanding. On June 17, the company declared a 10% stock dividend to stockholders of record on June 20. Market value of the stock was \$15 on June 17. The stock was distributed on June 30. The entry to record the transaction of June 30 would include a
- credit to Common Stock for \$80,000.
 - debit to Common Stock Dividends Distributable for \$120,000.
 - credit to Paid-in Capital in Excess of Par Value for \$40,000.
 - debit to Retained Earnings for \$40,000.

86. The following selected amounts are available for Sanders Company.

Retained earnings (beginning)	\$1,000
Net loss	100
Cash dividends declared	100
Stock dividends declared	50

What is its ending retained earnings balance?

- \$850
 - \$900
 - \$750
 - \$800
87. Turquoise and Topaz Sisters had retained earnings of \$10,000 on the balance sheet but disclosed in the footnotes that \$2,000 of retained earnings was restricted for plant expansion and \$1,000 was restricted for bond repayments. Cash of \$2,000 had been set aside for the plant expansion. How much of retained earnings is available for dividends?
- \$7,000
 - \$8,000
 - \$10,000
 - \$5,000
88. Irwin, Inc. had 300,000 shares of common stock outstanding before a stock split occurred, and 600,000 shares outstanding after the stock split. The stock split was
- 3 for 6.
 - 6 for 1.
 - 1 for 6.
 - 2 for 1.
89. Restricting retained earnings for the cost of treasury stock purchased is a
- contractual restriction.
 - legal restriction.
 - stock restriction.
 - voluntary restriction.
90. A prior period adjustment that corrects income of a prior period requires that an entry be made to
- an income statement account.
 - a current year revenue or expense account.
 - the retained earnings account.
 - an asset account.

91. If the board of directors authorizes a \$100,000 restriction of retained earnings for a future plant expansion, the effect of this action is to
- decrease total assets and total stockholders' equity.
 - increase stockholders' equity and decrease total liabilities.
 - decrease total retained earnings and increase total liabilities.
 - reduce the amount of retained earnings available for dividend declarations.
92. A credit balance in retained earnings represents
- the amount of cash retained in the business.
 - a claim on specific assets of the corporation.
 - a claim on the aggregate assets of the corporation.
 - the amount of stockholders' equity exempted from the stockholders' claim on total assets.
93. A net loss
- occurs if operating expenses exceed cost of goods sold.
 - is not closed to Retained Earnings if it would result in a debit balance.
 - is closed to Retained Earnings even if it would result in a debit balance.
 - is closed to the paid-in capital account of the stockholders' equity section of the balance sheet.
94. Prior period adjustments are reported
- in the footnotes of the current year's financial statements.
 - on the current year's balance sheet.
 - on the current year's income statement.
 - on the current year's retained earnings statement.
95. Retained earnings are occasionally restricted
- to set aside cash for dividends.
 - to keep the legal capital associated with paid-in capital intact.
 - due to contractual loan restrictions.
 - if preferred dividends are in arrears.
96. Retained earnings is increased by each of the following *except*
- net income.
 - prior period adjustments.
 - some disposals of treasury stock.
 - All of these increase retained earnings.
97. A prior period adjustment for understatement of net income will
- be credited to the Retained Earnings account.
 - be debited to the Retained Earnings account.
 - show as a gain on the current year's Income Statement.
 - show as an asset on the current year's Balance Sheet.
98. The retained earnings statement
- is the owners' equity statement for a corporation.
 - will show an addition to the beginning retained earnings balance for an understatement of net income in a prior year.
 - will not reflect net losses.
 - will, in some cases, fail to reconcile the beginning and ending retained earnings balances.

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99. In the stockholders' equity section of the balance sheet,
- Common Stock Dividends Distributable will be classified as part of additional paid-in capital.
 - Common Stock Dividends Distributable will appear in its own subsection of the stockholders' equity.
 - Additional Paid-in Capital appears under the subsection Paid-in Capital.
 - Dividends in arrears will appear as a restriction of Retained Earnings.
100. The return on common stockholders' equity is computed by dividing net income available to common stockholders by
- ending total stockholders' equity.
 - ending common stockholders' equity.
 - average total stockholders' equity.
 - average common stockholders' equity.
101. The return on common stockholders' equity is computed by dividing
- net income by ending common stockholders' equity.
 - net income by average common stockholders' equity.
 - net income less preferred dividends by ending common stockholders' equity.
 - net income less preferred dividends by average common stockholders' equity.

Use the following information for questions 102–103.

Carter Corporation had net income of \$250,000 and paid dividends of \$50,000 to common stockholders and \$20,000 to preferred stockholders in 2008. Carter Corporation's common stockholders' equity at the beginning and end of 2008 was \$870,000 and \$1,130,000, respectively. There are 100,000 weighted-average shares of common stock outstanding.

102. Carter Corporation's return on common stockholders' equity was
- 25%.
 - 23%.
 - 20%.
 - 18%.
103. Carter Corporation's earnings per share for 2008 was
- \$2.50.
 - \$2.30.
 - \$2.00.
 - \$1.80.

Use the following information for questions 104–105.

The following information pertains to Greenwich Company. Assume that all balance sheet amounts represent average balance figures.

Stockholders' equity—common	\$150,000
Total stockholders' equity	200,000
Sales	100,000
Net income	25,000
Number of shares of common stock	10,000
Common stock dividends	10,000
Preferred stock dividends	4,000

104. What is the return on common stockholders' equity ratio for Greenwich?
- 16.7%
 - 14.0%
 - 12.7%
 - 10.5%
105. What is the earnings per share for Greenwich?
- \$2.50
 - \$2.10
 - \$1.50
 - \$1.10
106. A corporation differs from a proprietorship and a partnership in that
- assets and liabilities are presented differently on the balance sheet.
 - a corporation is considered a separate legal entity for taxation purposes.
 - the cost principle only applies to proprietorships and partnerships.
 - the owners of the corporation do not have a claim on the net assets of the business.
107. Income statements for corporations are the same as the statements for proprietorships *except* for the reporting of
- gross profit.
 - income from operations.
 - income tax expense.
 - other revenues and gains.
108. Income statements for corporations are the same as the income statements for proprietorships *except* for the reporting of
- cost of goods sold.
 - income taxes.
 - gross profit.
 - other revenues and other expenses.
109. Corporation income tax expense is
- usually accrued in the adjusting entry process.
 - not usually accrued because it is not known what the exact liability will be until the tax return is filed.
 - not reported in a separate section of a corporate income statement.
 - reported similarly for corporations and partnerships.
110. When computing earnings per share,
- an adjustment related to preferred stock dividends is made in the numerator and denominator of the earnings per share formula.
 - an adjustment for the preferred dividends is made in the denominator of the earnings per share formula.
 - the dividends for cumulative preferred stock are deducted from net income only if the preferred dividends have been declared.
 - the dividends for cumulative preferred stock are deducted from net income whether or not preferred dividends have been declared.

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111. Each of the following statements is correct *except* that earnings per share is reported
- a. below net income.
 - b. for both common and preferred stock.
 - c. on the face of the income statement.
 - d. based on the weighted-average number of common shares outstanding.
112. West, Inc. has a net income of \$400,000 for 2008, and there are 200,000 weighted-average shares of common stock outstanding. Dividends declared and paid during the year amounted to \$80,000 on the preferred stock and \$120,000 on the common stock. The earnings per share for 2008 is
- a. \$2.00.
 - b. \$.60.
 - c. \$1.60.
 - d. \$1.00.
113. The formula for computing earnings per share is net income
- a. divided by the ending common shares outstanding.
 - b. divided by the weighted-average number of common shares outstanding.
 - c. less preferred dividends divided by the ending common shares outstanding.
 - d. less preferred dividends divided by the weighted-average number of common shares outstanding.

Additional Multiple Choice Questions

114. Which of the following statements about a cash dividend is *incorrect*?
- a. The legality of a cash dividend depends on state corporation laws.
 - b. The legality of a dividend does not indicate a company's ability to pay a dividend.
 - c. Dividends are not a liability until declared.
 - d. Shareholders usually vote to determine the amount of income to be distributed in the form of a dividend.
115. The date a cash dividend becomes a binding legal obligation to a corporation is the
- a. declaration date.
 - b. earnings date.
 - c. payment date.
 - d. record date.
116. Abbott Corporation splits its common stock 4 for 1, when the market value is \$40 per share. Prior to the split, Abbott had 50,000 shares of \$10 par value common stock issued and outstanding. After the split, the par value of the stock
- a. remains the same.
 - b. is reduced to \$2 per share.
 - c. is reduced to \$2.50 per share.
 - d. is reduced to \$10 per share.

117. Which of the following statements about retained earnings restrictions is *incorrect*?
- Many states require a corporation to restrict retained earnings for the cost of treasury stock purchased.
 - Long-term debt contracts may impose a restriction on retained earnings as a condition for the loan.
 - The board of directors of a corporation may voluntarily create retained earnings restrictions for specific purposes.
 - Retained earnings restrictions are generally disclosed through a journal entry on the books of a company.
118. Prior period adjustments
- may only increase retained earnings.
 - may only decrease retained earnings.
 - may either increase or decrease retained earnings.
 - do not affect retained earnings.
119. Jennifer Company reports the following amounts for 2008:
- | | |
|------------------------------|-----------|
| Net income | \$125,000 |
| Average stockholders' equity | 500,000 |
| Preferred dividends | 35,000 |
| Par value preferred stock | 100,000 |
- The 2008 rate of return on common stockholders' equity is
- 18.0%.
 - 22.5%.
 - 25.0%.
 - 31.3%.
120. The return on common stockholders' equity is computed by dividing
- net income by ending common stockholders' equity.
 - net income by average common stockholders' equity.
 - net income minus preferred dividends by ending common stockholders' equity.
 - net income minus preferred dividends by average common stockholders' equity.
121. Milner Corporation had 200,000 shares of common stock outstanding during the year. Milner declared and paid cash dividends of \$200,000 on the common stock and \$160,000 on the preferred stock. Net income for the year was \$880,000. What is Milner's earnings per share?
- \$2.60
 - \$3.40
 - \$3.60
 - \$4.40
122. When a corporation has both preferred and common stock outstanding, earnings per share is computed by dividing net income
- by ending common shares outstanding.
 - by weighted average common shares outstanding.
 - less preferred dividends by ending common shares outstanding.
 - less preferred dividends by the weighted average of common shares outstanding.

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123. In determining earnings per share, dividends for the current year on noncumulative preferred stock should be
- a. disregarded.
 - b. added back to net income whether declared or not.
 - c. deducted from net income only if declared.
 - d. deducted from net income whether declared or not.

Answers to Multiple Choice Questions

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
31.	b	45.	c	59.	c	73.	c	87.	a	101.	d	115.	a
32.	c	46.	d	60.	b	74.	d	88.	d	102.	b	116.	c
33.	b	47.	a	61.	d	75.	d	89.	b	103.	b	117.	d
34.	d	48.	b	62.	c	76.	b	90.	c	104.	b	118.	c
35.	a	49.	b	63.	b	77.	d	91.	d	105.	b	119.	a
36.	c	50.	a	64.	a	78.	d	92.	c	106.	b	120.	d
37.	d	51.	c	65.	d	79.	c	93.	c	107.	c	121.	c
38.	b	52.	b	66.	c	80.	a	94.	d	108.	b	122.	d
39.	b	53.	c	67.	a	81.	a	95.	c	109.	a	123.	c
40.	d	54.	d	68.	d	82.	c	96.	c	110.	d		
41.	a	55.	d	69.	a	83.	b	97.	a	111.	b		
42.	b	56.	b	70.	d	84.	a	98.	b	112.	c		
43.	c	57.	b	71.	a	85.	a	99.	c	113.	d		
44.	d	58.	d	72.	c	86.	c	100.	d	114.	d		

BRIEF EXERCISES**BE 124**

On November 27, the board of directors of India Star Company declared a \$.35 per share dividend. The dividend is payable to shareholders of record on December 7 on December 24. India Star has 25,500 shares of \$1 par common stock outstanding at November 27. Journalize the entries needed on the declaration and payment dates.

Solution 124 (4 min.)

Nov. 27	Retained Earnings	8,925	
	Dividends Payable		8,925
Dec. 24	Dividends Payable	8,925	
	Cash.....		8,925

BE 125

On October 10, the board of directors of Pitcher Corporation declared a 5% stock dividend. On October 10, the company had 10,000 shares of \$1 par common stock issued and outstanding with a market price of \$15 per share. The stock dividend will be distributed on October 31 to shareholders of record on October 25. Journalize the entries needed for the declaration and distribution of the stock dividend.

Solution 125 (5 min.)

Number of shares to be issued: 500 shares (small stock dividend)

Oct. 10	Retained Earnings (500 × \$15)	7,500	
	Common Stock Dividends Distributable		500
	Paid in Capital in Excess of Par		7,000
Oct. 31	Common Stock Dividends Distributable	500	
	Common Stock		500

BE 126

Devons Company has 24,000 shares of \$1 par common stock issued and outstanding. The company also has 2,000 shares of \$100 par 3% cumulative preferred stock outstanding. The company did not pay the preferred dividends in 2007 or 2008. What amount of dividends must the company pay the preferred shareholders in 2009 if they wish to pay the common stockholders a dividend?

Solution 126 (4 min.)

Annual preferred dividend: $2,000 \times \$100 \times 3\% = \$6,000$

Dividends for 2007, 2008 and 2009: $\$6,000 \times 3 = \$18,000$

BE 127

On November 1, 2008, Mates Corporation's stockholders' equity section is as follows:

Common stock, \$10 par value	\$600,000
Paid-in capital in excess of par value	180,000
Retained earnings	<u>200,000</u>
Total stockholders' equity	<u>\$980,000</u>

On November 1, Mates declares and distributes a 10% stock dividend when the market value of the stock is \$14 per share.

Instructions

Indicate the balances in the stockholders' equity accounts after the stock dividend has been distributed.

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Solution 127 (5 min.)

Common Stock	\$660,000*
Paid-in Capital in Excess of Par Value	204,000**
Retained Earnings	<u>116,000***</u>
Total Stockholders' Equity	<u>\$980,000</u>

*\$600,000 + (60,000 × .10 × \$10)

**\$180,000 + (60,000 × .10 × \$4)

***\$200,000 – (60,000 × .10 × \$14)

BE 128

Match each item/event pair below with the indicated change in the item. An individual classification may be used more than once, or not at all. For each dividend, assume that both declaration and payment or distribution has occurred.

Classifications

- A. Item increases
- B. Item decreases
- C. Item is unchanged
- D. Direction of change cannot be determined

	<i>Item</i>	<i>Event</i>
_____	1. Book value per share	Stock Dividend
_____	2. Total retained earnings	Stock Split
_____	3. Total stockholders' equity	Prior period adjustment increases last year's net income
_____	4. Earnings per common share	Restriction of retained Earnings
_____	5. Total retained earnings	Cash dividend
_____	6. Total paid-in capital	Stock dividend

Solution 128 (3 min.)

- | | |
|------|------|
| 1. B | 4. C |
| 2. C | 5. B |
| 3. A | 6. A |

BE 129

Identify which of the following items would be reported as additions (A) or deductions (D) in a Retained Earnings Statement.

- 1. Net Income
- 2. Net Loss
- 3. Cash Dividends
- 4. Stock Dividends
- 5. Prior period adjustments to correct for overstatement of prior years' net income
- 6. Prior period adjustments to correct for understatement of prior years' net income

Solution 129 (3 min.)

- | | |
|------|------|
| 1. A | 4. D |
| 2. D | 5. D |
| 3. D | 6. A |

BE 130

The balance in retained earnings on January 1, 2008, for Ettenger Inc, was \$600,000. During the year, the corporation paid cash dividends of \$70,000 and distributed a stock dividend of \$8,000. In addition, the company determined that it had overstated its depreciation expense in prior years by \$50,000. Net income for 2008 was \$100,000.

Instructions

Prepare the retained earnings statement for 2008.

Solution 130 (5 min.)

ETTENDER INC.
Retained Earnings Statement
For the Year Ended December 31, 2008

Balance, January 1 as reported		\$600,000
Correction for understatement of net income in prior period (depreciation expense error)		<u>50,000</u>
Balance, January 1, as adjusted		650,000
Add: Net income		<u>100,000</u>
		750,000
Less: Cash dividends	\$70,000	
Stock dividend	<u>8,000</u>	<u>78,000</u>
Balance, December 31		<u><u>\$672,000</u></u>

BE 131

The following information is available for Wheeler Corporation

	<u>2008</u>	<u>2007</u>
Average common stockholders' equity	\$1,500,000	\$1,000,000
Average total stockholders' equity	2,000,000	1,500,000
Common dividends declared and paid	72,000	50,000
Preferred dividends declared and paid	30,000	30,000
Net income	300,000	250,000

Instructions

Compute the return on common stockholders' equity ratio for both years. Briefly comment on your findings.

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Solution 131 (5 min.)

	<u>2007</u>	<u>2008</u>
Return on common stockholders' equity ratio:	$\frac{\$250,000 - \$30,000}{\$1,000,000} = \underline{\underline{22\%}}$	$\frac{\$300,000 - \$30,000}{\$1,500,000} = \underline{\underline{18\%}}$

Wheeler's return on common stockholders' equity ratio decreased approximately 18% during 2008. Wheeler's earnings increased during 2008 by 20%, but its average common stockholders' equity increased by 50%, causing the return on common stockholders' equity to decline by 18%.

BE 132

The following information is available for Ryder Corporation for the year ended December 31, 2008:

Corrected overstatement of 2007 depreciation expense	\$ 15,000
Cost of goods sold	600,000
Declared cash dividends	50,000
Operating expenses	170,000
Other expenses and losses	40,000
Other revenues and gains	50,000
Sales	1,000,000
Tax rate	30%

Instructions

Prepare a corporate income statement in good form.

Solution 132 (5 min.)

RYDER CORPORATION
Income Statement
For the Year Ended December 31, 2008

Sales		\$1,000,000
Cost of goods sold		<u>600,000</u>
Gross Profit		400,000
Operating Expenses		<u>170,000</u>
Income from operations		230,000
Other revenues and gains	\$50,000	
Other expenses and losses	<u>40,000</u>	<u>10,000</u>
Income before income taxes		240,000
Income tax expense (\$240,000 × 30%)		<u>72,000</u>
Net Income		<u><u>\$ 168,000</u></u>

EXERCISES**Ex. 133**

The stockholders' equity section of Ellis Corporation at December 31, 2007, included the following:

6% preferred stock, \$100 par value, cumulative, 10,000 shares authorized, 8,000 shares issued and outstanding	\$ 800,000
Common stock, \$10 par value, 250,000 shares authorized, 200,000 shares issued and outstanding	\$2,000,000

Dividends were not declared on the preferred stock in 2007 and are in arrears.

On September 15, 2008, the board of directors of Ellis Corporation declared dividends on the preferred stock for 2007 and 2008, to stockholders of record on October 1, 2008, payable on October 15, 2008.

On November 1, 2008, the board of directors declared a \$.90 per share dividend on the common stock, payable November 30, 2008, to stockholders of record on November 15, 2008.

Instructions

Prepare the journal entries that should be made by Ellis Corporation on the dates indicated below:

September 15, 2008	November 1, 2008
October 1, 2008	November 15, 2008
October 15, 2008	November 30, 2008

Solution 133 (12–15 min.)

9/15/08	Retained Earnings ($\$800,000 \times .06 \times 2$)	96,000	
	Preferred Dividends Payable		96,000
	(To record declaration of dividends in arrears and the current year's preferred dividend)		
10/1/08	(No entry required.)		
10/15/08	Preferred Dividends Payable	96,000	
	Cash		96,000
	(To record payment of cash preferred dividend)		
11/1/08	Retained Earnings	180,000	
	Common Dividends Payable		180,000
	(To record declaration of cash dividend on common stock)		
11/15/08	(No entry required.)		
11/30/08	Common Dividends Payable	180,000	
	Cash		180,000
	(To record payment of common cash dividends)		

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Ex. 134

Richman Corporation has 120,000 shares of \$5 par value common stock outstanding. It declared a 15% stock dividend on June 1 when the market price per share was \$12. The shares were issued on June 30.

Instructions

Prepare the necessary entries for the declaration and payment of the stock dividend.

Solution 134 (6–8 min.)

June 1	Retained Earnings (120,000 × .15 × \$12).....	216,000	
	Common Stock Dividends Distributable.....		90,000
	Paid-in Capital in Excess of Par Value		126,000
June 30	Common Stock Dividends Distributable	90,000	
	Common Stock		90,000

Ex. 135

Irving Corporation's stockholders' equity section at December 31, 2007 appears below:

Stockholders' equity		
Paid-in capital		
Common stock, \$10 par, 60,000 outstanding	\$600,000	
Paid-in capital in excess of par	<u>150,000</u>	
Total paid-in capital		\$750,000
Retained earnings		<u>150,000</u>
Total stockholders' equity		<u>\$900,000</u>

On June 30, 2008, the board of directors of Irving Corporation declared a 15% stock dividend, payable on July 31, 2008, to stockholders of record on July 15, 2008. The fair market value of Irving Corporation's stock on June 30, 2008, was \$15.

On December 1, 2008, the board of directors declared a 2 for 1 stock split effective December 15, 2008. Irving Corporation's stock was selling for \$20 on December 1, 2008, before the stock split was declared. Par value of the stock was adjusted. Net income for 2008 was \$190,000 and there were no cash dividends declared.

Instructions

- (a) Prepare the journal entries on the appropriate dates to record the stock dividend and the stock split.
- (b) Fill in the amount that would appear in the stockholders' equity section for Irving Corporation at December 31, 2008, for the following items:
1. Common stock \$ _____
 2. Number of shares outstanding _____
 3. Par value per share \$ _____
 4. Paid-in capital in excess of par \$ _____
 5. Retained earnings \$ _____
 6. Total stockholders' equity \$ _____

Solution 135 (12–16 min.)

(a)	6/30/08	Retained Earnings	135,000	
		Common Stock Dividends Distributable		90,000
		Paid-in Capital in Excess of Par		45,000
		(To record declaration of 15% stock dividend, 60,000 × 15% = 9,000 × \$15 = \$135,000)		
	7/15/08	(No entry required.)		
	7/31/08	Common Stock Dividends Distributable	90,000	
		Common Stock		90,000
		(To record issuance of 9,000 shares in a stock dividend)		
	12/1/08	(No entry required.)		
	12/15/08	Memo: 138,000 common shares outstanding \$5 par value.		

(b)	1.	Common stock	<u>\$ 690,000</u>
	2.	Number of shares outstanding	<u>138,000</u>
	3.	Par value per share	<u>\$ 5</u>
	4.	Paid-in capital in excess of par	<u>\$ 195,000</u>
	5.	Retained earnings	<u>\$ 205,000</u>
	6.	Total stockholders' equity	<u>\$1,090,000</u>

Ex. 136

Derek Corporation was organized on January 1, 2007. During its first year, the corporation issued 40,000 shares of \$5 par value preferred stock and 400,000 shares of \$1 par value common stock. At December 31, the company declared the following cash dividends:

2007	\$10,000
2008	\$30,000
2009	\$70,000

Instructions

- Show the allocation of dividends to each class of stock, assuming the preferred stock dividend is 6% and not cumulative.
- Show the allocation of dividends to each class of stock, assuming the preferred stock dividend is 8% and cumulative.
- Journalize the declaration of the cash dividend at December 31, 2009 using the assumption of part (b).

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Solution 136 (12–17 min.)

(a)	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
2007	\$10,000	\$ -0-	\$10,000
2008	12,000	18,000	30,000
2009	12,000	58,000	70,000

(b)	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
2007	\$10,000	\$ -0-	\$10,000
2008	22,000	8,000	30,000
2009	16,000	54,000	70,000

(c)	Retained Earnings.....	70,000	
	Preferred Dividends Payable		16,000
	Common Dividends Payable		54,000

Ex. 137

On November 1, 2008, Lambert Corporation's stockholders' equity section is as follows:

Common stock, \$10 par value	\$ 600,000
Paid-in capital in excess of par value	205,000
Retained earnings	<u>240,000</u>
Total stockholders' equity	<u>\$1,045,000</u>

On November 1, Lambert declares and distributes a 10% stock dividend when the market value of the stock is \$13 per share.

Instructions

- Compute the book value per share (1) before the stock dividend and (2) after the stock dividend.
- Indicate the balances in the stockholders' equity accounts after the stock dividend has been distributed.

Solution 137 (5–8 min.)

- Book value before the stock dividend: $\$1,045,000 \div 60,000 \text{ shares} = \17.42
 - Book value after the stock dividend: $\$1,045,000 \div 66,000 \text{ shares} = \15.83

(b)	Common Stock	\$ 660,000
	Paid-in Capital in Excess of Par Value	223,000
	Retained Earnings	<u>162,000</u>
	Total Stockholders' Equity	<u>\$1,045,000</u>

Ex. 138

During 2008, Pine Corporation had the following transactions and events:

1. Issued par value preferred stock for cash at par value.
2. Issued par value common stock for cash at an amount greater than par value.
3. Completed a 2 for 1 stock split in which the \$10 par value common stock was changed to \$5 par value stock.
4. Declared a small stock dividend when the market value was higher than the par value.
5. Declared a cash dividend.
6. Made a prior period adjustment for understatement of net income.
7. Issued par value common stock for cash at par value.
8. Paid the cash dividend.
9. Issued the shares of common stock required by the stock dividend declaration in 4. above.

Instructions

Indicate the effect(s) of each of the foregoing items on the subdivisions of stockholders' equity. Present your answers in tabular form with the following columns. Use (I) for increase, (D) for decrease, and (NE) for no effect.

<u>Item</u>	<u>Paid-in Capital</u>		<u>Retained Earnings</u>
	<u>Capital Stock</u>	<u>Additional Paid-in Capital</u>	

Solution 138 (9–13 min.)

<u>Item</u>	<u>Paid-in Capital</u>		<u>Retained Earnings</u>
	<u>Capital Stock</u>	<u>Additional Paid-in Capital</u>	
1.	I	NE	NE
2.	I	I	NE
3.	NE	NE	NE
4.	I	I	D
5.	NE	NE	D
6.	NE	NE	I
7.	I	NE	NE
8.	NE	NE	NE
9.	NE	NE	NE

Ex. 139

The following information is available for Ellis Corporation:

Common Stock (\$5 par)	\$1,500,000
Retained Earnings	600,000

A 10% stock dividend is declared and paid when the market value was \$15 per share.

Instructions

Compute each of the following after the stock dividend.

- (a) Total stockholders' equity.
- (b) Number of shares outstanding.
- (c) Book value per share.

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Solution 139 (6–8 min.)

- (a) Total stockholders' equity = \$2,100,000 (\$1,500,000 + \$600,000)*
*or $(\$1,500,000 \times 110\%) + [(\$15 - \$5) \times 30,000] + [\$600,000 - (30,000 \times \$15)]$
- (b) Number of shares outstanding = 330,000
 $[(\$1,500,000 \div \$5) \times 110\%]$
- (c) Book value per share = \$6.36 $(\$2,100,000 \div 330,000)$

Ex. 140

On January 1, 2008, Bolten Corporation had \$2,000,000 of \$10 par value common stock outstanding that was issued at par and retained earnings of \$1,000,000. The company issued 200,000 shares of common stock at \$13 per share on July 1. On December 15, the board of directors declared a 10% stock dividend to stockholders of record on December 31, 2008, payable on January 15, 2009. The market value of Bolten Corporation stock was \$15 per share on December 15 and \$16 per share on December 31. Net income for 2008 was \$500,000.

Instructions

- Journalize the issuance of stock on July 1 and the declaration of the stock dividend on December 15.
- Prepare the stockholders' equity section of the balance sheet for Bolten Corporation at December 31, 2008.

Solution 140 (10–15 min.)

(1) July 1	Cash	2,600,000	
	Common Stock		2,000,000
	Paid-in Capital in Excess of Par Value		600,000
Dec. 15	Retained Earnings (40,000 × \$15/sh)	600,000	
	Common Stock Dividends Distributable		400,000
	Paid-in Capital in Excess of Par Value		200,000

$(\$2,000,000 \div \$10 = 200,000 + 200,000 = 400,000 \text{ shares} \times .10 = 40,000 \text{ shares})$

(2) Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, \$10 par value, 400,000 shares issued and outstanding	\$4,000,000
Common stock dividends distributable	400,000
Total capital stock	4,400,000
Additional paid-in capital in excess of par value	800,000
Total paid-in capital	5,200,000
Retained earnings	900,000
Total stockholders' equity	<u>\$6,100,000</u>

Ex. 141

On January 1, 2008, Dolan Corporation had 60,000 shares of \$1 par value common stock issued and outstanding. During the year, the following transactions occurred:

- Mar. 1 Issued 20,000 shares of common stock for \$400,000.
 June 1 Declared a cash dividend of \$2.00 per share to stockholders of record on June 15.
 June 30 Paid the \$2.00 cash dividend.
 Dec. 1 Purchased 4,000 shares of common stock for the treasury for \$22 per share.
 Dec. 15 Declared a cash dividend on outstanding shares of \$2.25 per share to stockholders of record on December 31.

Instructions

Prepare journal entries to record the above transactions.

Solution 141 (12–17 min.)

Mar. 1	Cash	400,000	
	Common Stock		20,000
	Paid-in Capital in Excess of Par Value		380,000
June 1	Retained Earnings	160,000	
	Dividends Payable		160,000
	(80,000 × \$2 = \$160,000)		
June 30	Dividends Payable	160,000	
	Cash		160,000
Dec. 1	Treasury Stock	88,000	
	Cash		88,000
Dec. 15	Retained Earnings (76,000 × \$2.25)	171,000	
	Dividends Payable		171,000

Ex. 142

Record the following transactions for Harper Corporation on the dates indicated.

- On March 31, 2008, Harper Corporation discovered that Depreciation Expense on factory equipment for the year ended December 31, 2007, had been recorded twice, for a total amount of \$50,000 instead of the correct amount of \$25,000.
- On June 30, 2008, the company's internal auditors discovered that the April 2008 telephone bill for \$2,500 had erroneously been charged to the Interest Expense account.
- On August 14, 2008, cash dividends on preferred stock of \$110,000 declared on July 1, 2008, were paid.

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Solution 142 (8–12 min.)1. March 31, 2008

Accumulated Depreciation—Factory Equipment.....	25,000	
Retained Earnings		25,000
(To adjust depreciation error in a prior period)		

2. June 30, 2008

Telephone Expense	2,500	
Interest Expense.....		2,500
(To correct current period error)		

3. August 14, 2008

Preferred Dividends Payable.....	110,000	
Cash		110,000
(To record payment of preferred dividends)		

Ex. 143

The following information is available for Orson Corporation:

Retained Earnings, December 31, 2008	\$1,500,000
Net Income for the year ended December 31, 2009	\$ 250,000

The company accountant, in preparing financial statements for the year ending December 31, 2009, has discovered the following information:

The company's previous bookkeeper, who has been fired, had recorded depreciation expense on a machine in 2007 and 2008 using the double-declining-balance method of depreciation. The bookkeeper neglected to use the straight-line method of depreciation which is the company's policy. The cumulative effects of the error on prior years was \$15,000, ignoring income taxes. Depreciation was computed by the straight-line method in 2009.

Instructions

- (a) Prepare the entry for the prior period adjustment.
- (b) Prepare the retained earnings statement for 2009.

Solution 143 (12–15 min.)

(a) Accumulated Depreciation.....	15,000	
Retained Earnings		15,000
(To adjust for depreciation error in prior periods)		

(b)

ORSON CORPORATION
Retained Earnings Statement
For the Year Ended December 31, 2009

Balance January 1, as reported	\$1,500,000
Correction for overstatement of depreciation in prior period	<u>15,000</u>
Balance, January 1, as adjusted	1,515,000
Add: Net income	<u>250,000</u>
Balance, December 31	<u>\$1,765,000</u>

Ex. 144

The following information is available for Sanders Inc.:

Beginning retained earnings	\$600,000
Cash dividends declared	50,000
Net income for 2008	120,000
Stock dividend declared	10,000
Understatement of last year's depreciation expense	40,000

Instructions

Based on the preceding information, prepare a retained earnings statement for 2008.

Solution 144 (10 min.)

SANDERS INC.		
Retained Earnings Statement		
For the Year Ended December 31, 2008		
Beginning balance		\$600,000
Correction for overstatement of 2007 net income		<u>(40,000)</u>
Beginning balance, as adjusted		560,000
Add: Net income		<u>120,000</u>
		680,000
Less: Cash dividends	\$50,000	
Stock dividends	<u>10,000</u>	<u>60,000</u>
Ending balance		<u>\$620,000</u>

Ex. 145

On January 1, 2008, Windom Corporation had Retained Earnings of \$378,000. During the year, Windom had the following selected transactions:

1. Declared stock dividends of \$40,000.
2. Declared cash dividends of \$90,000.
3. A 2 for 1 stock split involving the issuance of 200,000 shares of \$5 par value common stock for 100,000 shares of \$10 par value common stock.
4. Suffered a net loss of \$70,000.
5. Corrected understatement of 2007 net income because of an inventory error of \$68,000.

Instructions

Prepare a retained earnings statement for the year.

Solution 145 (15 min.)

WINDOM CORPORATION		
Retained Earnings Statement		
For the Year Ended December 31, 2008		
Balance, January 1, as reported		\$378,000
Correction for understatement of 2007 net income (inventory error) ...		<u>68,000</u>
Balance, January 1, as adjusted		446,000
Less: Net loss		<u>(70,000)</u>
		376,000
Less: Cash dividends.....	\$90,000	
Stock dividends	<u>40,000</u>	<u>(130,000)</u>
Balance, December 31		<u>\$246,000</u>

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Ex. 146

The following accounts appear in the ledger of Norland Inc. after the books are closed at December 31, 2008.

Common Stock, \$1 par value, 500,000 shares authorized, 400,000 shares issued	\$400,000
Common Stock Dividends Distributable	80,000
Paid-in Capital in Excess of Par Value—Common Stock	650,000
Preferred Stock, \$100 par value, 8%, 10,000 shares authorized; 2,000 shares issued	200,000
Retained Earnings	950,000
Treasury Stock (10,000 common shares)	85,000
Paid-in Capital in Excess of Par Value—Preferred Stock	310,000

Instructions

Prepare the stockholders' equity section at December 31, 2008, assuming that retained earnings is restricted for plant expansion in the amount of \$200,000.

Solution 146 (15–20 min.)

NORLAND INC.
December 31, 2008

Stockholders' equity		
Paid-in capital		
Capital stock		
8% preferred stock, \$100 par value, 10,000 shares authorized, 2,000 shares issued		\$ 200,000
Common stock, \$1 par value, 500,000 shares authorized, 400,000 shares issued, 390,000 shares outstanding	\$400,000	
Common stock dividends distributable	<u>80,000</u>	<u>480,000</u>
Total capital stock		680,000
Additional paid-in capital		
In excess of par value—preferred	310,000	
In excess of par value—common	<u>650,000</u>	
Total additional paid-in capital		<u>960,000</u>
Total paid-in capital		1,640,000
Retained earnings (See note)		<u>950,000</u>
Total paid-in capital and retained earnings		2,590,000
Less: Treasury stock		<u>(85,000)</u>
Total stockholders' equity		<u>\$2,505,000</u>

Note: Retained earnings is restricted in the amount of \$200,000 for plant expansion.

Ex. 147

The following information is available for Wenger Corporation:

Beginning stockholders' equity	\$700,000
Dividends paid to common stockholders	50,000
Dividends paid to preferred stockholders	30,000
Ending stockholders' equity	800,000
Net income	165,000

Instructions

Based on the preceding information, calculate return on common stockholders' equity.

Solution 147 (4 min.)

$$\text{Return on common stockholders' equity} = \frac{\$165,000 - \$30,000}{\$750,000^*} = .18$$

$$^*(\$700,000 + \$800,000) \div 2$$

Ex. 148

Prepare a 2008 income statement for Carney Corporation based on the following information:

Cost of goods sold	\$420,000
Operating expenses	100,000
Other expenses and losses	30,000
Sales	700,000
Tax rate	30%

Solution 148 (7-10 min.)

CARNEY CORPORATION
Income Statement
For the Year Ended December 31, 2008

Sales	\$700,000
Cost of goods sold	<u>420,000</u>
Gross profit	280,000
Operating expenses	<u>100,000</u>
Income from operations	180,000
Other expenses and losses	<u>30,000</u>
Income before income taxes	150,000
Income tax expense (\$150,000 × .30)	<u>45,000</u>
Net income	<u><u>\$105,000</u></u>

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Ex. 149

Feldman Corporation gathered the following information for the fiscal year ended December 31, 2008:

Sales	\$1,600,000
Selling and administrative expenses	160,000
Cost of goods sold	1,040,000
Loss on sale of equipment	40,000

Feldman Corporation is subject to a 30% income tax rate.

Instructions

Prepare a partial income statement, beginning with income from operations.

Solution 149 (6–8 min.)

FELDMAN CORPORATION
Partial Income Statement
For the Fiscal Year Ended December 31, 2008

Income from operations (\$1,600,000 – \$1,040,000 – \$160,000)	\$400,000
Loss on sale of equipment	<u>40,000</u>
Income before income taxes	360,000
Income tax expense (\$360,000 × 30%)	<u>108,000</u>
Net income	<u><u>\$252,000</u></u>

Ex. 150

At December 31, 2008, Rossi Company has \$500,000 of \$100 par value, 8%, cumulative preferred stock outstanding and \$2,000,000 of \$10 par value common stock issued. Rossi's net income for the year is \$500,000.

Instructions

Compute earnings per share of common stock for 2008 under the following independent situations. (Round to two decimals.)

- (a) The dividend to preferred stockholders was declared, and there has been no change in the number of shares of common stock outstanding during the year.
- (b) The dividend to preferred stockholders was not declared, and 10,000 shares of common treasury stock were held throughout the year. The preferred stock is cumulative.

Solution 150 (9–12 min.)

(a) $(\$500,000 - \$40,000) \div 200,000 = \$2.30$

(b) $(\$500,000 - \$40,000) \div 190,000 = \$2.42$
 $200,000 - 10,000 = 190,000$

(Dividends on preferred stock that are cumulative must be deducted in the numerator, even if not declared.)

Ex. 151

The following information is available for Vincent Corporation:

Dividends paid to common stockholders	\$ 45,000
Dividends paid to preferred stockholders	20,000
Net income	145,000
Weighted average common shares outstanding	100,000

Instructions

Compute the earnings per share of common stock.

Solution 151 (4 min.)

Earnings per share = \$1.25 $[(\$145,000 - \$20,000) \div 100,000]$

COMPLETION STATEMENTS

152. Three important dates associated with dividends are the: (1)_____, (2)_____, and (3)_____.
153. The entry to record the declaration of a stock dividend increases _____, and decreases _____.
154. Both a stock split and a stock dividend will _____ the number of shares outstanding and have _____ on total stockholders' equity.
155. Corporations sometimes segregate retained earnings into two categories: (1)_____ retained earnings and (2)_____ retained earnings.
156. The correction of an error in previously issued financial statements is known as a _____.
157. The return on _____ shows how many dollars of net income were earned for each dollar invested by owners.
158. The return on common stockholders' equity is computed by dividing _____ minus _____ dividends by average common stockholders' equity.
159. Income statements for corporations report _____ in a separate section before net income.
160. Earnings per share is reported only for _____.
161. Earnings per share is calculated by dividing _____ available for common stockholders by the _____ number of common shares outstanding.

Answers to Completion Statements

152. declaration date, record date, payment date
153. Paid-in Capital, Retained Earnings
154. increase, no effect
155. restricted, unrestricted
156. prior period adjustment
157. common stockholders' equity
158. net income, preferred
159. income tax expense
160. common stock
161. net income, weighted average

MATCHING

162. Match the items below by entering the appropriate code letter in the space provided.

- | | |
|-----------------------------------|--|
| A. Deficit | F. Return on common stockholders' equity |
| B. Prior period adjustment | G. Cash dividend |
| C. Liquidating dividend | H. Declaration date |
| D. Retained earnings restrictions | I. Stock dividend |
| E. Earnings per share | J. Stock split |

- ___ 1. A dividend declared out of paid-in capital.
- ___ 2. Retained earnings currently unavailable for dividends.
- ___ 3. The correction of an error in previously issued financial statements.
- ___ 4. A pro rata distribution of cash to stockholders.
- ___ 5. A debit balance in retained earnings.
- ___ 6. A pro rata distribution of the corporation's own stock to stockholders.
- ___ 7. Shows how many dollars of net income were earned for each dollar invested by the owners.
- ___ 8. The date the board of directors formally declares the dividend and announces it to stockholders.
- ___ 9. The issuance of additional shares of stock to stockholders accompanied by a reduction in the par or stated value per share.
- ___ 10. Widely used by stockholders and potential investors in evaluating the profitability of a company.

Answers to Matching

- | | |
|------|-------|
| 1. C | 6. I |
| 2. D | 7. F |
| 3. B | 8. H |
| 4. G | 9. J |
| 5. A | 10. E |

SHORT-ANSWER ESSAY QUESTIONS

S-A E 163

The ultimate effect of incurring an expense is to reduce stockholders' equity. The declaration of a cash dividend also reduces stockholders' equity. Explain the difference between an expense and a cash dividend and explain why they have the same effect on stockholders' equity.

Solution 163

An expense is the cost of assets consumed or services used in the process of earning revenue. A cash dividend is part of the net income that is distributed to the stockholders. Thus, an expense is a cost incurred to earn net income while a cash dividend is a distribution to the stockholders of the net income earned.

An expense and a cash dividend, however, both result in a decrease in stockholders' equity, or more specifically, retained earnings. Expenses and cash dividends both decrease the amount of earned capital that is retained in the corporation.

S-A E 164

A large stock dividend and stock split can frequently have the same effect on the market price of a corporation's stock. Explain how stock dividends and stock splits affect the market price of a corporation's stock.

Solution 164

Stock dividends and stock splits both involve the issuance of additional shares of stock to the stockholders. The market price of a corporation's stock is affected because of an increase in the stock's marketability. A small stock dividend does not result in a large increase in the number of shares outstanding and therefore will not increase the stock's marketability. Thus, a small stock dividend will have little effect on the market price per share. However, both a large stock dividend and a stock split will cause a large increase in the number of shares outstanding. This increase in the number of shares outstanding makes the stock marketable to a larger number of individuals. Consequently, the market price per share will decrease.

S-A E 165

Why must a corporation have sufficient retained earnings before it may declare cash dividends?

Solution 165

By definition, a dividend is the distribution of profits to the corporate owners. Accordingly, to pay a dividend that exceeds existing retained earnings is, in substance, to return a portion of the stockholders' investment and in many states is illegal. In addition, companies are frequently constrained by agreements with their lenders to pay dividends only from retained earnings.

S-A E 166 (Ethics)

Jake Hightower, the president and CEO of Earth Systems, Inc., a waste management firm, was recently hospitalized, suffering from exhaustion and a heart ailment. Immediately prior to his hospitalization, Earth Systems had experienced a sharp decline in its stock price, and trading activity became almost nonexistent. The primary reason for this was concern expressed in the media over a new untested waste management system implemented by the company. Mr. Hightower had been unwilling to submit the procedure to testing before implementation, but he reluctantly agreed to limited tests after the system was operational. No problems have been identified by the tests to date.

The other members of management called a meeting to determine what they should do. Roger Donovan, the marketing manager, suggested that the company purchase a large number of shares of treasury stock. In that way, investors might notice that activity had picked up, and might decide to buy some more shares. This plan would use up most of the company's available cash, so that there will be no money available for a cash dividend. Earth Systems has paid cash dividends every quarter for over ten years.

Required:

1. Is Mr. Donovan's suggestion ethical? Explain.
2. Is it ethical to discontinue the cash dividend? Explain.

Solution 166

1. There is no definite answer as to whether Mr. Donovan's suggestion is ethical. There are several points that might be made, supporting either premise. First, it is a large transaction being made in the absence of the CEO, and made entirely to boost stock price. It is not clear what the long-term benefit to the company will be, even if it is successful. Thus, a student might argue that the large purchase of treasury stock, using up most of the available cash, might be unethical because of the potential damage done to the company, without a large enough potential reward. On the other hand, the company might benefit by keeping its stock price high (assuming that this purchase will enhance the stock price) by being able to issue additional shares of stock to finance future expansion. It is to be hoped that the students can articulate the concept that legality of an action is not the only determinate of whether an action is ethical.
2. A company may discontinue its dividend at will. Common shareholders should know that they are not entitled to a dividend, even when one has been declared and paid every year. There is no express or implied contract to pay a dividend to common shareholders, and so the discontinuance of the dividend is ethical. However, the company may lose more in share price by discontinuing a long-standing dividend than it gains by its large purchase of treasury stock.

S-A E 167 (Communication)

As part of a Careers in Accounting program sponsored by accounting organizations and supported by your company, you will be taking a group of high-school students through the accounting department in your company. You will also provide them with various materials to explain the work of an accountant. One of the materials you will provide is the Stockholders' Equity section of a recent balance sheet.

S-A E 167 (cont.)

Required:

Prepare a sentence or two explaining each major section: Common Stock, Additional Paid-in Capital, and Retained Earnings. You should try to be brief but clear.

Solution 167

Common Stock: When investors invest in our company, they purchase common stock. Part of the purchase price is shown in this section, and is called "par" value. Par value is a legal term, denoting the amount of money that the company must retain in order to satisfy creditors' claims, if the company should become insolvent.

Additional Paid-in Capital: The remainder of the amount paid by investors who purchase shares of stock in our company is shown in this section. Thus, the Common Stock section and the Additional Paid-in Capital section together show the amount paid by investors to purchase shares of our stock.

Retained Earnings: This shows the earnings that have been retained in the firm to finance future growth. The other earnings were paid to our stockholders as dividends.